SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

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Amendments to Rule 15c3–1 and Rule 17a–11 Applicable to Broker-Dealers Also Registered as Futures Commission Merchants

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is proposing for comment amendments to conform provisions of its net capital rule to changes to the net capital rule of the Commodity Futures Trading Commission. The proposed amendments would apply to broker-dealers also registered as futures commission merchants with the Commodity Futures Trading Commission. The Securities and Exchange Commission also is proposing to amend certain rules related to subordinated debt agreements to conform those rules to the Commodity Futures Trading Commission's amended net capital rules. Finally, the Securities and Exchange Commission is proposing to amend its early warning provisions to require that it be notified if a broker-dealer also registered as a futures commission merchant must warn the Commodity Futures Trading Commission or a designated self-regulatory organization that its adjusted net capital has fallen below specified levels.

DATES: Comments should be received on or before November 13, 2006.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's *Internet comment form* (*http://www.sec.gov/rules/proposed.shtml*); or
- Send an e-mail to *rule-comments@sec.gov*. Please include File Number S7–16–06 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–16–06. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/proposed.shtml*). Comments also are available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director, at (202) 551–5525; Thomas K. McGowan, Assistant Director, at (202) 551–5521; or Bonnie L. Gauch, Special Counsel, at (202) 551–5524, Division of Market Regulation, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–6628.

I. Introduction

The Securities and Exchange Commission (''Commission'') is proposing to amend its financial responsibility rules for broker-dealers registered with the Commodity Futures Trading Commission (''CFTC'') under the Commodity Exchange Act (''CEA'') as futures commission merchants (''FCMs''). The Commission's net capital rule, Rule 15c3–1,[1] imposes minimum financial (net capital) requirements on broker-dealers. The CFTC's adjusted net capital rule, Rule 1.17,[2] similarly imposes minimum financial requirements on FCMs. Under Rule 15c3–1(a)(1)(iii), a broker-dealer/FCM must maintain net capital of no less than the greater of its requirements under the applicable provisions of Rule 15c3–1 or four percent of the funds that must be segregated under the CEA and its rules. The requirement to maintain at least four percent of segregated funds was intended to conform Rule 15c3–1 to the CFTC's Rule 1.17.[3]

In 2004, the CFTC amended Rule 1.17 and adopted certain new net capital requirements applicable to FCMs.[4] Before adoption of the amended capital requirements, Rule 1.17(a)(1)(i)(A)–(D) required an FCM to maintain minimum adjusted net capital equal to, or in excess of, the greatest of the following: (1) $250,000; (2) four percent of an amount that equals the total of funds required to be segregated for customer trading on U.S. commodity markets under section 4d(a)(2) of the CEA and the funds required to be secured for customer trading on foreign commodity markets under Rule 30.7 to the CEA, less the market value of options purchased by customers for which the full premiums have been paid (''segregated funds''); (3) the amount of adjusted net capital required by a registered futures association; or (4) for broker-dealer/FCMs, the amount of net capital required under Rule 15c3–1(a).

CFTC Rule 1.17(a)(1)(i)(B), as amended, eliminates the four percent of segregated funds provision. Instead, the amended rule requires an FCM to maintain adjusted net capital equal to a specified percentage of the margin required to be collected under exchange or clearing organization rules. Under amended CFTC Rule 1.17(a)(1)(i)(B), an FCM must maintain adjusted net capital equal to the following: (1) Eight percent of the total risk margin requirement[5] for positions carried by the FCM in customer accounts;[6] plus (2) four percent of the total risk margin requirement for positions carried by the FCM in noncustomer accounts.[7]

The CFTC intended changes to Rule 1.17 to address material limitations on the segregated funds method of computing net capital.[8] For example, the segregated funds method did not reflect fully the extent to which an FCM was exposed to commodity positions carried for both customers and noncustomers. The segregated funds method did not include ''funds held by an FCM on behalf of foreign-domiciled customers trading on foreign commodity markets, nor [did] it include funds held by an FCM on behalf of noncustomers trading on either U.S. or foreign futures and options markets.''[9] This method also did not include ''letters of credit deposited as margin or reflect the additional risks posed by open positions in customer accounts that liquidate to a deficit.''[10] Finally, the segregated funds method of calculating net capital ''subjects an FCM to a higher

[1] 17 CFR 240.15c3–1. Section 15(c)(3) of the Securities Exchange Act of 1934 (the ''Exchange Act'') authorizes the Commission to impose, by regulation, minimum financial requirements on broker-dealers (15 U.S.C. 78o(c)(3)).

[2] 17 CFR 1.17.

[3] *See* Exchange Act Release No. 15898 (Jun. 5, 1979), 44 FR 24884 (Jun. 15, 1979).

[4] The new rules became effective on September 30, 2004. *See* 69 FR 49784 (Aug. 12, 2004).

[5] CFTC Rule 1.17(b)(8) defines ''risk margin'' (17 CFR 1.17(b)(8)).

[6] CFTC Rule 1.17(b)(7) defines ''customer account'' (17 CFR 1.17(b)(7)).

[7] CFTC Rule 1.17(b)(4) defines ''noncustomer account'' (17 CFR 1.17(b)(4)).

[8] *See* 68 FR 40835, 40837 (July 9, 2003).

[9] *Id.*

[10] *Id.*

requirement in situations where the FCM requires additional margin from customers or carries free credit balances for its customers, despite the risk reducing effect of holding higher levels of customer funds.'' [11] The CFTC amended Rule 1.17 to address these concerns and conform its net capital requirement to the net capital requirements implemented by the National Futures Association (''NFA''), two exchanges, and a clearing organization.

The Commission is proposing to amend Rule 15c3–1 to reflect the amendments to CFTC Rule 1.17, and is also proposing to amend paragraph (c) of Rule 17a–11,[12] which generally requires a broker-dealer to notify the Commission and its designated examining authority (''DEA'') if it fails to maintain certain levels of net capital.

II. Proposed Amendments

A. Amendments to Rule 15c3–1

1. Amendments to Rule 15c3–1(a)(1)(iii)

The Commission is proposing to amend Rule 15c3–1(a)(1)(iii) to conform to amended CFTC Rule 1.17. The proposed amendments to Rule 15c3–1(a)(1)(iii) would require a broker-dealer/FCM to maintain net capital of not less than the greater of the following: (1) Its requirement under paragraph (a)(1)(i) or (ii) of Rule 15c3–1; or (2) eight percent of the total risk margin requirement for positions carried by the FCM in customer accounts plus four percent of the total risk margin requirement for positions carried by the FCM in noncustomer accounts (''risk margin-based capital requirement'').

2. Amendments to Rule 15c3–1(e)(2)(ii)

The Commission also is proposing to amend Rule 15c3–1(e)(2)(ii) to conform it to CFTC Rule 1.17(e)(1)(ii). Rule 15c3–1(e)(2)(ii) prohibits a broker-dealer/FCM from withdrawing equity capital if the withdrawal would cause the broker-dealer/FCM's net capital to fall below, among other standards, a specified percentage of its minimum net capital dollar amount or a specified level of aggregate indebtedness, or its ''net capital would be less than 7 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder'' after the withdrawal. The Commission is proposing to replace the seven percent of segregated funds requirement with the amended CFTC Rule 1.17(e)(1)(ii) requirement of 120 percent of the risk margin-based capital requirement.

B. Amendments to Appendix D to Rule 15c3–1

The Commission also is proposing to amend certain provisions of Appendix D to Rule 15c3–1 (''Rule 15c3–1d''),[13] which contains minimum and non-exclusive requirements for satisfactory broker-dealer subordination agreements. Specifically, the Commission is proposing to amend paragraphs (b)(6)(iii), (b)(7), (b)(8)(i)(A), (b)(10)(ii)(B), (c)(2), (c)(5)(i)(B), (c)(5)(ii)(A), and (c)(7) of Rule 15c3–1d, which relate to repayment and prepayment of subordinated debt. Both Rule 15c3–1 and CFTC Rule 1.17 prohibit a broker-dealer or an FCM, respectively, from repaying or prepaying subordinated debt if the payments would cause the broker-dealer's or FCM's net capital to fall below certain thresholds.

1. Amendments to Rule 15c3–1d(b)(6)(iii)

The Commission is proposing to replace the segregated funds requirement of Rule 15c3–1d(b)(6)(iii) with a risk margin-based capital requirement to conform it to the CFTC's amended Rule 1.17(h)(2)(vi)(C)(*2*). Rule 15c3–1d(b)(6)(iii) permits a subordinated lender to reduce the unpaid principal amount of a secured demand note pledged to a broker-dealer with the consent of the broker-dealer and its DEA. The reduction, however, may not cause the broker-dealer's aggregate indebtedness to exceed a specified level of net capital or its net capital to fall below a specified level of aggregate debit items or, if the broker-dealer also is registered as an FCM, its net capital to fall below seven percent of the funds that must be segregated under the CEA and its rules, if that segregated amount is greater. The proposed amendment to Rule 15c3–1d(b)(6)(iii) would conform to amended CFTC Rule 1.17(h)(2)(vi)(C)(*2*) and replace the seven percent of segregated funds requirement with 120 percent of the risk margin-based capital requirement.

2. Amendments to Rule 15c3–1d(b)(7)

The Commission is proposing to replace the segregated funds requirement of Rule 15c3–1d(b)(7) with a risk margin-based capital requirement to conform it to the CFTC's amended Rule 1.17(h)(2)(vii)(A)(*2*). Rule 15c3–1d(b)(7) permits a broker-dealer to prepay subordinated debt if the prepayment occurs at least one year after the effective date of the subordination agreement and the broker-dealer meets certain other requirements. A broker-dealer/FCM may not prepay subordinated debt, however, if the prepayment would cause its aggregated indebtedness to exceed a specified level of net capital or its net capital to fall below a specified percentage of the minimum net capital dollar amount, fall below a specified level of aggregate debit items or, if the broker-dealer also is registered as an FCM, its net capital to fall below seven percent of the funds that must be segregated under the CEA and its rules, if that amount is greater. The proposed amendment to Rule 15c3–1d(b)(7) would conform to amended CFTC Rule 1.17(h)(2)(vii)(A)(*2*) and replace the seven percent of segregated funds requirement with 120 percent of the risk margin-based capital requirement.

3. Amendments to Rule 15c3–1d(b)(8)(i)(A)

The Commission is proposing to replace the segregated funds requirement of Rule 15c3–1d(b)(8)(i)(A) with a risk margin-based capital requirement to conform it to the CFTC's amended Rule 1.17(h)(2)(viii)(A)(*2*). Rule 15c3–1d(b)(8)(i)(A) requires a broker-dealer/FCM to suspend repayment of subordinated debt if the repayment would cause its aggregated indebtedness to exceed a specified level of net capital or its net capital to fall below a specified level of aggregate debit items or, if the broker-dealer also is registered as an FCM, its net capital to fall below six percent of the funds required to be segregated under the CEA and its rules, if that amount is greater. The proposed amendment to Rule 15c3–1d(b)(8)(i)(A) would conform to amended CFTC Rule 1.17(h)(2)(viii)(A)(*2*) and replace the six percent of segregated funds requirement with 120 percent of the risk margin-based capital requirement.

4. Amendments to Rule 15c3–1d(b)(10)(ii)(B)

The Commission also is proposing to replace the segregated funds requirement of Rule 15c3–1d(b)(10)(ii)(B) to reflect the CFTC's risk margin-based capital requirements. Rule 15c3–1d(b)(10)(ii)(B) limits the events of default that may accelerate a broker-dealer/FCM's obligation to repay subordinated debt. Those events of default occur if a broker-dealer/FCM's aggregate indebtedness exceeds 1500 percent of its net capital, its net capital computed under Rule 15c3–1(a)(1)(ii) is less than two percent of aggregate debit

[11] *Id.*

[12] 17 CFR 240.17a–11(c).

[13] 17CFR 240.15c3–1d.

items as computed under Rule 15c3–3a, or its net capital is less than four percent of the funds required to be segregated under the CEA and its rules, if that amount is greater. The proposed amendment to Rule 15c3–1(b)(10)(ii)(B) would replace the four percent of segregated funds requirement with the risk margin-based capital requirements of proposed Rule 15c3–1(a)(1)(iii).

5. Amendments to Rule 15c3–1d(c)(2)

Furthermore, the Commission is proposing to replace the segregated funds requirement of Rule 15c3–1d(c)(2) with a risk margin-based capital requirement to conform it to the CFTC's amended Rule 1.17(h)(3)(ii)(B). Rule 15c3–1d(c)(2) requires a broker-dealer/FCM to notify its DEA if repayment of its subordinated debt would cause its aggregate indebtedness to exceed 1200 percent of its net capital; its net capital to be less than 120 percent of the minimum dollar amount required by Rule 15c3–1; less than five percent of aggregate debit items computed in accordance with Rule 15c3–3a; or its net capital to be less than six percent of the funds required to be segregated under the CEA and its rules, if that amount is greater. The proposed amendment to Rule 15c3–1d(c)(2) would conform to amended CFTC Rule 1.17(h)(3)(ii)(B) and replace the six percent of segregated funds requirement with 120 percent of the risk margin-based capital requirement.

6. Amendments to Rule 15c3–1d(c)(5)(i)(B)

The Commission also is proposing to replace the segregated funds requirement of Rule 15c3–1d(c)(5)(i)(B) with a risk margin-based capital requirement to conform it to the CFTC's amended Rule 1.17(h)(3)(v)(B). Rule 15c3–1d(5)(i)(B) permits a broker-dealer to enter into temporary subordination agreements (terms of no more than 45 days), subject to specified conditions, so that the broker-dealer may engage in securities underwriting and other extraordinary activities. A broker-dealer/FCM operating under Rule 15c3–1(a)(1)(ii) may not enter into a temporary subordination agreement, however, if its net capital is less than five percent of its aggregate debit items computed under Rule 15c3–3a or seven percent of the funds required to be segregated under the CEA or its rules, if that amount is greater. The proposed amendment to Rule 15c3–1d(c)(5)(i)(B) would conform to amended CFTC Rule 1.17(h)(3)(v)(B) and replace the seven percent of segregated funds requirement with 120 percent of the risk margin-based capital requirement.

7. Amendments to Rule 15c3–1d(c)(5)(ii)(A)

Finally, the Commission is proposing to replace the segregated funds requirement of Rule 15c3–1d(c)(5)(ii)(A) with a risk margin-based capital requirement to conform it to the CFTC's amended Rule 1.17(h)(2)(vii)(B)(*2*). Rule 15c3–1d(c)(5)(ii)(A) permits a broker-dealer to enter into a revolving subordinated loan agreement that provides for prepayment within less than one year. A broker-dealer/FCM may not prepay subordinated debt, however, if, as a result of the prepayment, its aggregate indebtedness would exceed 900 percent of its net capital; its net capital would be less than 200 percent of the minimum dollar amount required under Rule 15c3–1; its net capital would be less than six percent of aggregate debit items computed under Rule 15c3–3a (for broker-dealer operating under Rule 15c3–1(a)(1)(ii)); or its net capital would be less than ten percent of the funds required to be segregated under the CEA or its rules, if that amount is greater. The proposed amendment to Rule 15c3–1d(c)(5)(ii)(A) would conform to amended CFTC Rule 1.17(h)(2)(vii)(B)(*2*) and replace the ten percent of segregated funds requirement with 125 percent of the risk margin-based capital requirement.

8. Applicability of Amendments to Rule 15c3–1d to Existing Subordination Agreements

Under the proposed amendments to Rule 15c3–1d(c)(7), satisfactory subordination agreements that comply with Rule 15c3–1d, as in effect before adoption of these proposed amendments to that rule, would continue to be deemed satisfactory until their maturity date, if the agreements are not amended or renewed. However, all subordination agreements would be required to meet the requirements of amended Rule 15c3–1d within five years of adoption of these proposed amendments to that rule. Amendments to, or renewals of, subordination agreements would be required to comply with the proposed amendments to Rule 15c3–1d, as would any new subordination agreements. This proposed ''grandfathering'' provision is intended to allow broker-dealer/FCMs sufficient time to comply with the proposed amendments to subordinated debt rules in a manner that is not unduly burdensome on either the broker-dealer/FCMs or their DEAs, which must approve subordinated debt agreements under Appendix D.

C. Rationale for the Amendments to Rules 15c3–1 and 15c3–1d

The Commission believes that the proposed amendments to Rules 15c3–1 and 15c3–1d are necessary and appropriate. First, compliance with both the current Commission and the amended CFTC rules could impose duplicative or conflicting obligations on a broker-dealer/FCM because the rules may apply different standards. Under current Rule 15c3–1(a)(1)(iii) and amended CFTC Rule 1.17, a broker-dealer/FCM must maintain net capital equal to at least the greatest of its requirements under Rule 15c3–1(a)(1)(i) or (ii), four percent of the funds required to be segregated under the CEA and its applicable rules, or the risk margin-based capital requirement under amended CFTC Rule 1.17. That is, a broker-dealer/FCM must maintain net capital equal to at least the Commission minimum applicable to broker-dealers, the now-eliminated CFTC segregated funds minimum, or the new CFTC minimum applicable to FCMs. Section 15 of the Exchange Act requires the Commission to issue those rules, in consultation with the CFTC, that are necessary to avoid imposing duplicative or conflicting financial responsibility regulations on broker-dealer/FCMs.[14] The proposed amendments to Rules 15c3–1 and 15c3–1d are intended to avoid imposing potentially duplicative or conflicting regulations on broker-dealer/FCMs by eliminating the four percent of segregated funds requirement and replacing it with a risk margin-based capital requirement identical to that contained in amended CFTC Rule 1.17.

Second, the risk margin-based capital requirement applicable to FCMs should be an adequate substitute for the previous segregated funds standard. The risk margin-based requirement has been in place at futures exchanges for a number of years without significant problems.

Third, the proposed amendments to Rule 15c3–1 also are necessary to avoid potentially placing a broker-dealer/FCM at a competitive disadvantage with respect to entities registered solely as broker-dealers or FCMs. Sole registrants might be subject to lower regulatory

[14] Section 15 of the Exchange Act requires the Commission, in consultation with the CFTC, to: issue such rules, regulations, or orders as are necessary to avoid duplicative or conflicting regulations applicable to any broker or dealer registered with the Commission pursuant to section 15(b) (except paragraph (11) thereof), that is also registered with the Commodity Futures Trading Commission pursuant to section 4f(a) of the Commodity Exchange Act * * * with respect to application of * * * financial responsibility rules. 15 U.S.C. 78o(c)(3)(B).

costs than a combined broker-dealer/FCM, which could be required to maintain higher capital than either the broker-dealer or FCM net capital rules would require a sole registrant to maintain.

Fourth, the proposed amendments should provide the Commission with enhanced ability to monitor the financial position of broker-dealer/FCMs. The proposed amendments to Rule 15c3–1 would permit the Commission to oversee a broker-dealer/FCM for capital problems arising from the firm's futures business. A broker-dealer/FCM might be in a financial position in which its net capital otherwise is sufficient for the securities aspect of Rule 15c3–1, but is insufficient for purposes of the risk margin-based capital requirement for its futures business. Under the proposed amendments to Rule 15c3–1, a broker-dealer's failure to maintain sufficient risk margin-based capital, which is a violation of CFTC Rule 1.17, also would be a violation of the Commission's net capital rule. The Commission, therefore, could force the broker-dealer/FCM to take corrective action (or require it to cease conducting business), an ability the Commission would not have without the proposed amendments.

D. Amendments to Rule 17a–11, Notification Provisions for Brokers and Dealers

We are proposing to amend paragraph (c) of Rule 17a–11,[15] which generally requires a broker-dealer to notify the Commission and its DEA if it fails to maintain certain levels of net capital. Specifically, the Commission is proposing to amend paragraph (c) of Rule 17a–11 to redesignate existing paragraph (c)(4) as paragraph (c)(5); and add a new paragraph (c)(4).

Proposed new paragraph (c)(4) would require a broker-dealer/FCM to notify the Commission and its DEA under circumstances in which the CFTC's rules would require an FCM to provide notification to the CFTC that its adjusted net capital had fallen below a particular threshold. We are proposing these amendments to help protect customers from broker-dealer failures. Current Rule 17a–11 does not require a broker-dealer/FCM to notify the Commission if its adjusted net capital under the CFTC's net capital rule falls below specified requirements. The proposed notification requirement should provide an early warning to the Commission that a broker-dealer/FCM may be experiencing financial difficulties whatever the source and allow the Commission to take corrective action with respect to the firm, if necessary. The proposed amendments to Rule 17a–11 also are consistent with amended CFTC Rule 1.12(b)(2),[16] which requires an FCM to notify the CFTC and its designated self-regulatory organization if its adjusted net capital falls below 110% of its risk margin-based requirements under 1.17(a)(1)(i)(B).

[15] 17 CFR 240.17a–11(c).

III. Request for Comments

We invite interested persons to submit written comments on all aspects of the proposed amendments. Further, we invite comment on other matters that might have an effect on the proposals contained in the release.

IV. Paperwork Reduction Act

Certain provisions of the proposed amendments to Rule 17a–11 [17] contain ''collection of information requirements'' within the meaning of the Paperwork Reduction Act of 1995.[18] The Commission has submitted the proposed amendments to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The Commission is revising the collection of information entitled, ''Rule 17a–11 (17 CFR 240.17a–11) Notification Provision for Brokers and Dealers,'' OMB Control Number 3235–0085. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

A. Collection of Information under these Amendments

As discussed, the Commission is proposing to amend Rule 17a–11 to provide the Commission with an early warning of a broker-dealer/FCM's low capital level, which should help protect customers from broker-dealer failures. The proposed amendments to paragraph 17a–11(c)(4) would require a broker-dealer/FCM to notify the Commission and its DEA under circumstances in which the CFTC's rules would require an FCM to provide notification that its adjusted net capital had fallen below a particular threshold.

[16] 17 CFR 1.12(b)(2).

[17] There is no new collection of information imposed on broker-dealer/FCMs under the amendments to Rules 15c3–1 and 15c3–1d. The Commission's and CFTC's rules, both in previous form and as amended, require broker-dealer/FCMs to comply with the net capital rules of both agencies. Accordingly, the proposed amendments to Rules 15c3–1 and 15c3–1d do not impose any new requirements on broker-dealer/FCMs.

[18] 44 U.S.C. 3501 *et seq.*

B. Proposed Use of Information

The Commission would use the information collected under the proposed amendments to Rule 17a–11 to determine if a broker-dealer is in compliance with financial responsibility rules. Specifically, the Commission would use the information to monitor whether broker-dealer/FCMs are complying with the net capital rule and relevant notification requirements.

C. Respondents

The proposed amendments to Rule 17a–11 would apply only to broker-dealer/FCMs. As of July 31, 2006, there were approximately 67 broker-dealer/FCMs.[19] A broker-dealer/FCM would be required to notify the Commission and its DEA under circumstances in which the CFTC's rules would require an FCM to provide notification that its adjusted net capital had fallen below a particular threshold.

D. Total Annual Reporting and Recordkeeping Burden

Under the proposed amendment to Rule 17a–11(c)(4), a broker-dealer/FCM would be required to notify the Commission and its DEA under circumstances in which the CFTC's rules would require an FCM to provide notification that its adjusted net capital had fallen below a particular threshold. The Commission staff estimates that 5 out of 67 broker-dealer/FCMs will file Rule 17a–11 notifications annually.[20] The staff further estimates that these broker-dealer/FCMs would spend annually approximately 1.25 hours (or .25 hours each × 5 broker-dealer/FCMs) to send the notifications.[21]

E. Collection of Information Is Mandatory

The collection of information under the proposed amendments to Rule 17a–11 is mandatory if a broker-dealer/FCM's net capital falls below the Commission's or the CFTC's early warning thresholds.

[19] Selected FCM Financial Data as of July 31, 2006, CFTC Division of Clearing and Intermediary Oversight.

[20] There were approximately 5,980 registered broker-dealers as of December 31, 2005. Approximately 450, or 7.5% (450/5,980), of those firms filed early warning notices under Rule 17a–11. The Commission, therefore, expects that 5 broker-dealer/FCMs (approximately 7.5% of 67 broker-dealer/FCMs) would file early warning notices annually under Rule 17a–11.

[21] A broker-dealer/FCM is already required to draft and send these notifications to the CFTC or DSROs pursuant to CFTC Rules. Consequently, the only additional cost relates to the additional time it would take the broker-dealer/FCM's staff to send the notification to the Commission and its DEA. The Staff estimates, based on its experience, that it would take an individual 15 minutes to send these additional notifications.

F. Confidentiality

The collection of information under the proposed amendments to Rule 17a–11(c)(4) would be provided to the Commission and to a broker-dealer/FCM's DEA, but would not be subject to public availability.

G. Record Retention Period

Rule 17a–4(b)(4) requires a broker-dealer to preserve copies of all communications sent relating to its business as such for no less than three years, the first two years in an accessible place.

H. Request for Comment

Under 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to:

(i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility;

(ii) Evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information;

(iii) Enhance the quality, utility, and clarity of the information to be collected; and

(iv) Minimize the burden of the collection of information on those required to respond, including through the use of automated collection techniques or other forms of information technology.

Persons who desire to submit comments on the collection of information requirements should direct them to OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090, and refer to File No. S7–16–06. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this document in the **Federal Register**; therefore, comments to OMB are best assured of having full effect if OMB receives them within 30 days of this publication. The Commission has submitted the proposed collections of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–16–06, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE., Washington, DC 20549.

V. Costs and Benefits of the Proposed Amendments

A. Introduction

As discussed, the Commission is proposing to amend Exchange Act Rules 15c3–1(a)(1)(iii) and (e)(2)(ii); 15c3–1d(b)(6)(iii), (b)(7), (b)(8)(i)(A), (b)(10)(ii)(B), (c)(2), (c)(5)(i)(B), (c)(5)(ii)(A), and (c)(7); and 17a–11(c)(3), (c)(4), and (c)(5). The CFTC amended Rules 1.17 and 1.12 to adopt certain new net capital requirements applicable to FCMs.[22] Broker-dealer/FCMs must comply with both the CFTC's and the Commission's net capital rules under Rule 15c3–1(a)(1)(iii). Accordingly, the Commission is amending Rules 15c3–1 and 15c3–1d to conform those rules to the CFTC's amendments. Finally, the Commission is amending Rule 17a–11 to provide itself with an early warning that a broker-dealer/FCM may be experiencing financial difficulties.

The Commission has identified below certain costs and benefits associated with its proposed amendments. We encourage commenters to discuss, analyze, and supply relevant data regarding any additional costs or benefits.

B. Benefits

We believe that the proposed amendments to Rules 15c3–1 and 15c3–1d will benefit both broker-dealer/FCMs and investors. As discussed, the Commission is proposing to amend Rule 15c3–1(a)(1)(iii) by eliminating the rule's segregated funds requirement and replacing it with the risk margin-based capital requirement. Rule 15c3–1(a)(1)(iii) requires a broker-dealer/FCM to maintain net capital of not less than the greater of its requirement under Rule 15c3–1 or four percent of the funds required to be segregated under the CEA and its rules. The four percent of segregated funds requirement was intended to conform Rule 15c3–1(a)(1)(iii) to Rule 1.17, the CFTC's adjusted net capital rule, and ensure that a broker-dealer/FCM complied with the net capital rules of both the CFTC and the Commission. Rule 1.17, as amended, eliminates the four percent of segregated funds requirement and replaces it with a new risk margin-based capital requirement. Proposed Rule 15c3–1(a)(1)(iii) would require a broker-dealer/FCM to maintain net capital of not less than the greater of its requirement under Rule 15c3–1 or a risk margin-based capital requirement identical to the one contained in CFTC Rule 1.17, as amended.

We also are proposing to amend Rule 15c3–1(e)(2)(ii) to conform it to the CFTC's new risk margin-based capital requirement. Rule 15c3–1(e)(2)(ii) prohibits a broker-dealer/FCM from withdrawing equity capital if the withdrawal would cause the broker-dealer/FCM's net capital to fall below, among other standards, a specified percentage of its minimum net capital dollar amount, a specified level of aggregate indebtedness, or a specified percentage of the funds required to be segregated under the CEA. CFTC Rule 1.17(e)(1)(ii), as amended, prohibits an FCM from withdrawing equity capital if the withdrawal would cause the FCM's adjusted net capital to fall below a specified percentage of risk margin-based capital, rather than a specified percentage of segregated funds. The proposed amendments would substitute the segregated funds requirement in Rule 15c3–1(e)(2)(ii) with a risk margin-based requirement calculated under Rule 15c3–1(a)(1)(iii).

Furthermore, the Commission is proposing amendments to various provisions of Rule 15c3–1d, which contains minimum and non-exclusive requirements for satisfactory subordination agreement involving broker-dealers. Repayment and prepayment of subordinated debt under Rule 15c3–1d generally is permissible only if the broker-dealer/FCM maintains net capital equal to at least a specified percentage of net capital calculated under Rule 15c3–1 and a specified percentage of segregated funds. Rather than permitting repayment or prepayment of subordinated debt if an FCM maintains a specified percentage of segregated funds, the CFTC's Rule 1.17, as amended, permits repayment or prepayment if the FCM maintains net capital equal to at least a specified percentage of its risk margin-based capital requirement. Accordingly, the Commission is proposing to amend Rule 15c3–1d by substituting the risk margin-based capital requirement for the segregated funds requirement to avoid subjecting broker-dealer/FCMs to conflicting or duplicative regulation.

The Commission believes that the risk margin-based capital requirement is appropriate. Each of the amendments to Rules 15c3–1 and 15c3–1d substitutes the risk margin-based capital requirement for the segregated funds standard. The risk margin-based capital requirement should be an adequate substitute for the segregated funds standard based on its implementation and use by the futures exchanges and FCMs' comfort level with the requirement.

[22] *See supra*, note 4.

As noted, the Commission also believes that the amendments to Rules 15c3–1 and 15c3–1d would benefit both broker-dealer/FCMs and investors. First, the proposed amendments would prevent the imposition of potentially conflicting or duplicative regulation on a broker-dealer/FCM. Current Rule 15c3–1(a)(1)(iii) requires a broker-dealer/FCM to maintain net capital equal to the greater of its net capital requirement under Rule 15c3–1 or four percent of the funds required to be segregated under the CEA and its rules. The four percent of segregated funds requirement reflects the previous version of CFTC Rule 1.17 and has been substituted in current CFTC Rule 1.17 with the risk margin-based capital requirement. The proposed amendments would substitute the risk margin-based capital requirement for the segregated funds requirement in Rules 15c3–1 and 15c3–1d and, therefore, free a broker-dealer/FCM from complying with a capital requirement no longer applicable to FCMs that are sole registrants.

Second, the proposed amendments would help to avoid potentially placing a broker-dealer/FCM at a competitive disadvantage with respect to an entity registered solely as a broker-dealer or FCM. Neither a broker-dealer nor an FCM is subject to the four percent of segregated funds requirement; a broker-dealer/FCM is subject to such a requirement unless the proposed amendments are adopted. Accordingly, the proposed amendments could free a broker-dealer/FCM from making three separate capital computations (one based on Rule 15c3–1(a)(1)(i) or (ii), one based on CFTC Rule 1.17, and one based on the four percent of segregated requirement under current Rule 15c3–1(a)(1)(iii)) and holding unnecessarily more net capital than its sole registrant competitors.

Third, the proposed amendments would enhance the Commission's ability to monitor the financial condition of a broker-dealer/FCM. Under the proposed amendments to Rule 15c3–1, a broker-dealer's failure to maintain sufficient risk margin-based capital, which is a violation of CFTC Rule 1.17, also would be a violation of the Commission's net capital rule. The Commission, therefore, could force the broker-dealer/FCM to take corrective action (or require it to cease conducting business), an ability the Commission would not have without the proposed amendments.

Finally, the proposed amendments to Rule 17a–11 would help protect customers from broker-dealer failures. Current Rule 17a–11 does not require a broker-dealer/FCM to notify the Commission if its adjusted net capital falls below specified requirements. The proposed amendments to Rule 17a–11 would require a broker-dealer/FCM to notify the Commission if its net capital falls below certain thresholds determined in accordance with Rule 15c3–1 or if the CFTC's rules would require it to notify the CFTC or a DSRO that its adjusted net capital had breached certain thresholds. This notification requirement should provide an early warning to the Commission that a broker-dealer/FCM may be experiencing financial difficulties.

C. Costs

There would be no costs associated with the proposed amendments to Rules 15c3–1 and 15c3–1d. A broker-dealer/FCM already must comply with the net capital rules of both the Commission and the CFTC. Likewise, a broker-dealer/FCM already must comply with Rule 15c3–1d and comparable CFTC subordinated debt rules.

The proposed amendments would help ensure that broker-dealer/FCMs are not subject to inconsistent or duplicative regulation under Rules 15c3–1 and 15c3–1d by eliminating the four percent of segregated funds standard in those rules and replacing it with the risk margin-based capital requirement. With respect to 15c3–1d, the applicable thresholds no longer will be calculated based upon a segregated funds, but upon risk margin-based, capital, which the broker-dealer/FCM already calculates under CFTC Rule 1.17.

As discussed, proposed Rule 17a–11(c)(4) would require a broker-dealer/FCM to notify the Commission and its DEA under circumstances in which the CFTC's rules would require an FCM to notify the CFTC or a DRSO that its adjusted net capital had fallen below a particular threshold. The cost of notification in these circumstances should be minimal because the broker-dealer/FCM already must notify the CFTC.[23] We estimate the annual cost of notification under Rule 17a–11(c)(4) would be $331 (.25 hours × $265 per hour for a financial reporting manager[24] × 5 broker-dealer/FCMs).[25]

[23] *See supra*, note 21.

[24] A financial reporting manager is a person at a broker-dealer with responsibility for helping to ensure that the broker-dealer complies with its financial reporting requirements with respect to the Commission, other federal or state agencies and SROs.

[25] Security Industry Association's (''SIA'') *Report on Management & Professional Earnings in the Securities Industry 2005*, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. The amount also reflects the average between New York City salaries and Non-New York City salaries. This is the latest report on financial industry salaries that is available from the SIA.

VI. Consideration of Burden on Competition, and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act[26] requires the Commission, whenever it engages in rulemaking and must consider or determine if an action is necessary or appropriate in the public interest, to consider if the action will promote efficiency, competition, and capital formation. Under section 23(a)(2) of the Exchange Act,[27] the Commission must consider the impact of its rulemaking on competition. It also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

We preliminarily believe that the amendments to Rules 15c3–1, 15c3–1d, and 17a–11 would promote efficiency, competition, and capital formation. The amendments to Rules 15c3–1 and 15c3–1d should promote efficiency because they would help to ensure that broker-dealer/FCMs are not subject to net capital requirements beyond those that the Commission already imposes on broker-dealers and those that the CFTC already imposes on FCMs. That is, the amendments would not subject broker-dealer/FCMs to any new requirements and, consequently, would not impose any new costs. Furthermore, the proposed amendments to Rule 17a–11(c)(4) should promote efficiency because they would require a broker-dealer/FCM to notify the Commission that it has fallen below a specified percentage of its adjusted net capital requirement under CFTC rules, a notification that it already must provide to the CFTC. This notification should help the Commission address potential financial difficulties at a broker-dealer/FCM before a liquidation becomes necessary and, therefore, should help protect customers. Each of these provisions also should help foster competition because they would allow firms to function jointly as broker-dealer/FCMs without imposing regulatory requirements beyond those already applicable to broker-dealers and FCMs individually.

We preliminarily believe that the proposed amendments to Rules 15c3–1, 15c3–1d and 17a–11would promote capital formation. By eliminating potentially duplicative or conflicting regulation, the proposed amendments to

[26] 15 U.S.C. 78c(f).

[27] 15 U.S.C. 78w(a)(2).

Rules 15c3–1 and 15c3–1d should help to ensure that a broker-dealer/FCM does not unnecessarily use its assets to meet regulatory capital requirements, freeing those assets for business uses. Similarly, the proposed amendments to Rule 17a–11 should help the Commission to identify a broker-dealer/FCM that faces potential financial difficulties and allow the Commission to take corrective action to help that broker-dealer/FCM preserve its capital which, in turn, should help protect the broker-dealer/FCM's customers.

Finally, we preliminarily believe that the proposed amendments do not impose any competitive burden that is not necessary and appropriate in furtherance of the purposes of the Exchange Act. As discussed, the Commission is proposing amendments to Rules 15c3–1 and 15c3–1d to conform those rules to the CFTC's amended net capital rule. The proposed rules are intended to eliminate inconsistent and duplicative regulation on broker-dealer/FCMs. Furthermore, we preliminarily believe that the proposed amendments to Rule 17a–11 are necessary to provide the Commission with an early warning of potential capital insufficiencies at broker-dealer/FCMs. This early warning should help the Commission to protect customers and the integrity of the markets. The amendments to Rule 17a–11(c)(4), moreover, would require only that a broker-dealer/FCM forward to the Commission a notice that it already must provide to the CFTC.

VII. Regulatory Flexibility Act Certification

The Commission hereby certifies, pursuant to 5 U.S.C. 605(b), that the proposed amendments to Rule 15c3–1, Rule 15c3–1d, and Rule 17a–11, if adopted, would not have a significant economic impact on a substantial number of small entities. The proposed amendments would apply only to broker-dealers also registered as FCMs. As of July 31, 2006, there were approximately 67 broker-dealer/FCMs.[28] Only one of those broker-dealers would qualify as a small entity.[29] Accordingly, we do not believe that the proposed amendments would have a significant economic impact on a substantial number of small entities.

We encourage written comments regarding this certification. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

VIII. Consideration of Impact on The Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or ''SBREFA,'' [30] we must advise OMB as to whether the proposed regulation constitutes a ''major'' rule. Under SBREFA, a rule is considered ''major'' if, upon adoption, it results or is likely to result in:

- An annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effect on competition, investment or innovation.

If a rule is ''major,'' its effectiveness will generally be delayed for 60 days pending Congressional review. We request comment on the potential impact of the proposed regulation on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

IX. Statutory Authority

The Commission is proposing amendments to Rule 15c3–1, Rule 15c3–1d, and Rule 17a–11 under the Exchange Act pursuant to the authority conferred by the Exchange Act, including Sections 15, 17 and 23(a).[31]

Text of Proposed Rule Amendments

List of Subjects in 17 CFR Part 240

Brokers, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Commission hereby proposes that Title 17, Chapter II of the Code of Federal Regulation be amended as follows.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–l, 78k, 78k–1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78ll, 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Section 240.15c3–1 is amended by revising paragraphs (a)(1)(iii) and (e)(2)(ii) to read as follows:

§ 240.15c3–1 Net capital requirements for brokers or dealers.

(a) * * *

(1) * * *

(iii) No broker or dealer registered as a futures commission merchant shall permit its net capital to be less than the greater of its requirement under paragraph (a)(1)(i) or (ii) of this section, or eight percent of the total risk margin requirement for positions carried by the futures commission merchant in customer accounts plus four percent of the total risk margin requirement for positions carried by the futures commission merchant in noncustomer accounts, as defined in the Commodity Exchange Act (7 U.S.C. 1 *et seq.*) and the rules thereunder.

* * * * *

(e) * * *

(2) * * *

(ii) The broker-dealer is registered as a futures commission merchant, its net capital would be less than 120 percent of the aggregate amount of its total risk margin requirements for positions carried in customer and noncustomer accounts under paragraph (a)(1)(iii) of this section;

* * * * *

3. Section 240.15c3–1d is amended by removing the authority citation at the end of the section and revising paragraphs (b)(6)(iii), (b)(7), (b)(8)(i)(A), (b)(10)(ii)(B), (c)(2), (c)(5)(i)(B), (c)(5)(ii)(A), and (c)(7) to read as follows:

§ 240.15c3–1d Satisfactory Subordination Agreements (Appendix D to 17 CFR 240.15c3–1).

* * * * *

(b) * * *

(6) * * *

(iii) The secured demand note agreement also may provide that, in lieu of the procedures specified in the provisions required by paragraph (b)(6)(ii) of this section, the lender, with the prior written consent of the broker or dealer and the Examining Authority for the broker or dealer, may reduce the unpaid principal amount of the secured demand note. After giving effect to such reduction, the aggregate indebtedness of the broker or dealer may not exceed 1000 percent of its net capital or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3–1, net capital may not be less than 5 percent of aggregate debit items computed in accordance with § 240.15c3–3a, or, if registered as a futures commission merchant, 120

[28] Selected FCM Financial Data as of July 31, 2006, CFTC Division of Clearing and Intermediary Oversight.

[29] *See* 17 CFR 240.0–10.

[30] Pub. L. No. 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

[31] 15 U.S.C. 78o, 78q and 78w(a).

percent of the aggregate amount of its total risk margin requirements for positions carried in customer and noncustomer accounts under paragraph (a)(1)(iii) of § 240.15c3–1, if greater. No single secured demand note shall be permitted to be reduced by more than 15 percent of its original principal amount and after such reduction no excess collateral may be withdrawn. No Examining Authority shall consent to a reduction of the principal amount of a secured demand note if, after giving effect to such reduction, net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3–1.

Permissive Prepayments

(7) A broker or dealer at its option, but not at the option of the lender may, if the subordination agreement so provides, make a Payment of all or any portion of the Payment Obligation thereunder prior to the scheduled maturity date of such Payment Obligation (hereinafter referred to as a ''Prepayment''), but in no event may any Prepayment be made before the expiration of one year from the date such subordination agreement became effective. This restriction shall not apply to temporary subordination agreements that comply with the provisions of paragraph (c)(5) of this Appendix D. No Prepayment shall be made, if, after giving effect thereto (and to all Payments of Payment Obligations under any other subordinated agreements then outstanding the maturity or accelerated maturities of which are scheduled to fall due within six months after the date such Prepayment is to occur pursuant to this provision or on or prior to the date on which the Payment Obligation in respect of such Prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the broker or dealer, either aggregate indebtedness of the broker or dealer would exceed 1000 percent of its net capital or its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3–1 or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3–1, its net capital would be less than 5 percent of its aggregate debit items computed in accordance with § 240.15c3–3a, or if registered as a futures commission merchant, 120 percent of the aggregate amount of its total risk margin requirements for positions carried in customer and noncustomer accounts under paragraph (a)(1)(iii) of § 240.15c3–1, if greater, or its net capital would be less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of § 240.15c3–1. Notwithstanding the provisions of this paragraph, no Prepayment shall occur without the prior written approval of the Examining Authority for such broker or dealer.

Suspended Repayment

(8)(i) * * *

(A) The aggregate indebtedness of the broker or dealer would exceed 1200 percent of its net capital, or in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3–1, its net capital would be less than 5 percent of aggregate debit items computed in accordance with § 240.15c3–3a or, if registered as a futures commission merchant, 120 percent of the aggregate amount of its total risk margin requirements for positions carried in customer and noncustomer accounts under paragraph (a)(1)(iii) of § 240.15c3–1, if greater, or

* * * * *

(10) * * *

(ii) * * *

(B) The aggregate indebtedness of the broker or dealer exceeding 1500 percent of its net capital or, in the case of a broker or dealer that has elected to operate under paragraph (a)(1)(ii) of § 240.15c3–1, its net capital is less than 2 percent of its aggregate debit items computed in accordance with § 240.15c3–3a or, if registered as a futures commission merchant, the aggregate amount of its total risk margin requirements for positions carried in customer and noncustomer accounts under paragraph (a)(1)(iii) of § 240.15c3–1, if greater, throughout a period of 15 consecutive business days, commencing on the day the broker or dealer first determines and notifies the Examining Authority for the broker or dealer, or the Examining Authority or the Commission first determines and notifies the broker or dealer of such fact;

* * * * *

(c) * * *

(2) Every broker or dealer shall immediately notify the Examining Authority for such broker or dealer if, after giving effect to all Payments of Payment Obligations under subordination agreements then outstanding that are then due or mature within the following six months without reference to any projected profit or loss of the broker or dealer either the aggregate indebtedness of the broker or dealer would exceed 1200 percent of its net capital or its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3–1, or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3–1, its net capital would be less than 5 percent of aggregate debit items computed in accordance with § 240.15c3–3a, or, if registered as a futures commission merchant, 120 percent of the aggregate amount of its total risk margin requirements for positions carried in customer and noncustomer accounts under paragraph (a)(1)(iii) of § 240.15c3–1, if greater, or less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of § 240.15c3–1.

* * * * *

(5) * * *

(i) * * *

(B) In the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3–1, its net capital is less than 5 percent of aggregate debits computed in accordance with § 240.15c3–3a, or, if registered as a futures commission merchant, less than 120 percent of the aggregate amount of its total risk margin requirements for positions carried in customer and noncustomer accounts under paragraph (a)(1)(iii) of § 240.15c3–1, if greater, or less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of this section, or

* * * * *

(ii) * * *

(A) After giving effect thereto (and to all Payments of Payment Obligations under any other subordinated agreements then outstanding, the maturity or accelerated maturities of which are scheduled to fall due within six months after the date such prepayment is to occur pursuant to this provision or on or prior to the date on which the Payment Obligation in respect of such prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the broker or dealer, either aggregate indebtedness of the broker or dealer would exceed 900 percent of its net capital or its net capital would be less than 200 percent of the minimum dollar amount required by § 240.15c3–1 or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3–1, its net capital would be less than 6 percent of aggregate debit items computed in accordance with § 240.15c3–3a, or, if registered as a futures commission merchant, 125 percent of the aggregate amount of its total risk margin requirements for positions carried in customer and noncustomer accounts under paragraph (a)(1)(iii) of § 240.15c3–1, if greater, or its net capital

would be less than 200 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of this section or

* * * * *

(7) *Subordination agreements in effect before adoption.* Any subordination agreement that incorporates the net capital requirements in paragraphs (b)(6)(iii), (b)(7), (b)(8)(i), (b)(10)(ii)(B), (c)(2), (c)(5)(i)(B), and (c)(5)(ii)(A) of this section, as in effect before adoption of the amendments incorporating the risk margin-based capital requirement in those paragraphs, and that has been deemed to be satisfactorily subordinated pursuant to § 240.15c3–1 as in effect before adoption of those amendments, shall continue to be deemed a satisfactory subordination agreement until the maturity of the agreement. *Provided,* That if the agreement is amended or renewed for any reason, then the agreement shall not be deemed a satisfactory subordination agreement unless the amended or renewed agreement meets the requirements of this Appendix D. *Provided, further,* That all subordination agreements must meet the requirements of this Appendix D within 5 years of the adoption of the amendments incorporating the risk margin-based capital requirements.

4. Section 240.17a–11 is amended by:

a. Revising the introductory text of paragraph (c);

b. In paragraph (c)(3) remove the period at the end of the paragraph and in its place add ''; or'';

c. Redesignating paragraph (c)(4) as paragraph (c)(5); and

d. Adding new paragraph (c)(4) to read as follows:

§ 240.17a–11 Notification provisions for brokers and dealers.

* * * * *

(c) Every broker or dealer shall send notice promptly (but within 24 hours) after the occurrence of the events specified in paragraph (c)(1), (c)(2), (c)(3), (c)(4) or (c)(5) of this section in accordance with paragraph (g) of this section:

* * * * *

(4) For a broker or dealer registered as a futures commission merchant, if the Commodity Exchange Act (7 U.S.C. 1 *et seq.*) and the rules promulgated under the Commodity Exchange Act would require a futures commission merchant to provide notification to the Commodity Futures Trading Commission or a designated self-regulatory organization that its adjusted net capital has fallen below a specified threshold; or

* * * * *

Dated: October 5, 2006.

By the Commission.

J. Lynn Taylor,

Assistant Secretary.

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